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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 153

J. E. FARRELL, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL
REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH
CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 36-45) is reported in 45 B. T. A. 162. The opinion of the Circuit Court of Appeals (R. 289-291) is reported at 134 F. 2d 193.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 5, 1943 (R. 292). Rehearing was denied April 10, 1943 (R. 296). The petition

for a writ of certiorari was filed July 9, 1943. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether payments reserved under an assignment of oil and gas leases were income to the taxpayer-assignor reporting on the cash basis, when received by him in 1936 or in earlier years when the oil was run but the assignees refused to make the payments because of pending litigation in which the taxpayer's former wife asserted an interest in the funds.¹

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set forth in the Appendix, *infra*.

¹ In separate proceedings for redetermination of deficiencies assessed for the years 1933 and 1936 which were consolidated in the Board of Tax Appeals for hearing and report (R. 10, 12, 26), it was stipulated that if the oil payments represented income for 1936, as the Commissioner asserted, there would be a deficiency in tax for that year and an overpayment of tax for 1933 (R. 86). The Board of Tax Appeals, confirming the Commissioner, entered its orders accordingly (R. 45-47). The Commissioner petitioned for review from the order (R. 46) determining an overpayment of tax for the year 1933, as a matter of protection in the event the Circuit Court determined that the oil payments were not properly taxable in 1936 (R. 69-72). The cases were consolidated for briefing, hearing, argument, and decision in the court below (R. 125-126), and a single judgment of affirmance entered (R. 292).

STATEMENT

The facts material to the issues raised by the petitioner may be summarized from the findings of the Board of Tax Appeals as follows (R. 27-36):

On March 11, 1931, petitioner and his then wife, Stella B. Farrell, owned as community property an undivided one-half of the seven-eighths working interest in certain Texas oil and gas leases and equipment. The remaining interest was owned by four individuals. (R. 27.) On that date, the coowners transferred all interest in the leases to the Yount-Lee Oil Company, a Texas corporation, for cash, deferred payments payable in 1931, and \$2,000,000, which the instrument of assignment provided was (R. 27)—

to be paid out of one-fourth ($\frac{1}{4}$) of said Yount-Lee Oil Company's working interest in the oil and/or gas produced and saved from the lands covered by this assignment, if, as and when produced and saved and only in such event, free of all cost and expense to Grantors; it being expressly understood in this connection that said Yount-Lee Oil Company shall be under no obligations to Grantors to drill upon or develop said lands, or any part thereof

except to drill offset wells under certain specified conditions. If Yount-Lee sold the oil it was to account to petitioner as produced "on the basis of the sale price at the well received by said Yount-Lee Oil Company," but in no event at less than the

posted price or 30 cents per barrel. Young-Lee was given an option to purchase the oil at the posted price (any oil run to be considered a purchase), subject to a minimum price of 30 cents per barrel. Payments were to be made to the grantors in the month next following the month in which the oil was produced and saved. Petitioner's share of the oil payment as community property was 50%. (R. 27-28.)

In July 1931, petitioner's wife filed suit for divorce and for partition of their community property. In granting the decree, the Texas court ordered that petitioner recover from the plaintiff as his own separate property all the property of the community estate, the parties having entered into a property settlement agreement whereby the plaintiff wife accepted the sum of \$750 per month for life in lieu of a partition of the community estate. Shortly after the divorce, the former Mrs. Farrell married one Burguières, and in November 1931, she and Burguières jointly conveyed to petitioner in confirmation of the property settlement and decree, all interest including her community interest, in amounts paid and to be paid by Yount-Lee under the assignment of March 11, 1931. (R. 28.)

In 1933, Stella B. Burguières filed suit against petitioner and Yount-Lee in the Texas District Court, alleging that the property settlement agreement incident to her divorce from petitioner

was void as fraudulently procured. The prayer of the petition included a request for a temporary order restraining petitioner from receiving any further payments under the oil lease assignments. (R. 28.) On July 5, 1933, the court issued the restraining order as prayed, and on August 16, 1933, such temporary restraining order was by stipulation continued in force until trial of the case on the merits (R. 29).

In an amended petition filed May 5, 1934, Mrs. Burguières alleged that the proceeding was brought to recover of both defendants an undivided one-half interest in the \$1,000,000 oil payment, the other one-half being charged with an equitable lien in her favor to secure reimbursement for the part withheld from her by petitioner, and for one-half of the community estate accumulated during their marriage. She asked that the property settlement agreement be declared null and void, that the decree of the court respecting the community estate be vacated, that a judgment be entered for an equitable partition of the community estate as of August 8, 1931 (the date of the divorce decree), that all property then in possession of petitioner be declared to be community property, that she recover of both defendants one-half of the \$1,000,000 oil payment, and that any personal judgment against petitioner be protected by an equitable lien upon the oil payment. Petitioner answered, denying the allegations. (R. 29.)

When the proceeding came on for hearing, the court directed a verdict for the defendants, and on June 8, 1934, entered judgment and vacated all restraining orders issued in the case accordingly (R. 31). The plaintiff, without filing a supersedeas or applying for any interim injunction, appealed to the Court of Civil Appeals, which affirmed the judgment of the court below on June 28, 1935. Further proceedings in the case continued, however, until March 11, 1936. (R. 31-32.)

During all of 1933, 1934, and 1935 Yount-Lee or Stanolind Oil and Gas Company, which in July of 1935 succeeded to Yount-Lee's rights in the leases, sold or ran gas and oil produced from the leases under the assignment agreement of March 11, 1931; payments were made regularly to petitioner each month until the commencement of suit by his former wife. Commencing with oil runs made in June 1933, and gas runs made in April 1933, payments to petitioner were discontinued. (R. 32.) Yount-Lee thereafter deposited in escrow the payments due petitioner for the balance of 1933, for 1934 and for part of 1935; the rest of the 1935 payments were retained by its assignee, Stanolind Oil and Gas Company. The amount so accumulated aggregated \$402,-672.82. (R. 32.)

Petitioner made no demands upon Young-Lee while the injunction was in effect. In December of 1934, he made a formal demand for payment,

to which Yount-Lee's counsel responded that in the opinion of the company it was necessary to hold the money "in suspense" until the Burguieres suit was finally disposed of or an agreement reached between the plaintiff and defendant therein with reference to these funds, even though petitioner had obtained judgment in the lower court and no supersedeas bond had been filed. In August and again in November, 1935, petitioner was informed that the assignees deemed it unsafe to pay him the amount due without protection against liability to Stella R. Burguieres. Negotiations looking toward payment under indemnity were never consummated. Other demands for payment during 1935 and 1936 were refused. In March 1936, petitioner brought suit against the withholders to recover the payments due under the contract, alleging repeated demands and refusals, and asking special damages in the sum he would be required to pay in additional income taxes by reason of the withholding; the suit was still pending at the time of the hearing of this matter before the Board of Tax Appeals. (R. 32-35.)

During the period in which the assignees withheld payment, they rendered petitioner monthly statements showing the amounts due him under the assignments as the oil and gas was run. The amounts payable to him were credited on the books of Yount-Lee in an account headed "J. E. Farrell". (R. 35.)

In April of 1936, the withheld funds were paid over to petitioner because of the termination of the Burguieres litigation (R. 35).

The income-tax returns of petitioner for the years 1933 to 1936, both inclusive, were made on the cash basis. He did not treat any part of these payments on his books or in his original income-tax returns as taxable income to him for the years 1933, 1934, and 1935. In September 1936, petitioner filed amended returns for 1933, 1934, and 1935, and included therein as taxable income the amounts payable to him under the assignments for oil and gas sold or run during each period. (R. 35-36.)

In his determination of a deficiency for 1936, the Commissioner included the entire amount in petitioner's taxable income for that year (R. 35). The Board of Tax Appeals confirmed the Commissioner's ruling (R. 47), and its decision was affirmed by the court below (R. 292) on the ground that the funds did not become available to petitioner reporting on the cash basis, or subject to his control and disposition until 1936, that at all times prior thereto the possibility existed that he might never receive them, and that Yount-Lee was not petitioner's agent, partner, or joint venturer so as to make the income taxable to him in the prior years as income distributable though undistributed (R. 290-291).

ARGUMENT

Further review of this case is unwarranted; it was correctly decided in the court below and no conflict is presented.

Petitioner made his returns on the cash basis (R. 36). None of the amount here involved was paid to him until 1936; and under the allegations (R. 152-171) and broad scope of the prayer (R. 172-173) of the petition in the suit instituted by taxpayer's former wife, manifestly until the litigation ended in that year it was uncertain that petitioner would ever receive any part of these funds.

Since petitioner reported on the cash basis, it would not be material were it true as asserted (Pet. 8-9), that the litigation challenged his right only to one-half of the oil payments and that no uncertainty existed therefore with respect to the remainder. Where a taxpayer makes his returns on the cash basis the question, of course, is only whether he received the amount during the taxable year. Pending outcome of the former wife's suit, the assignees withheld these funds in their entirety. Nor was any of the amount subject to petitioner's disposition and control so as to be "constructively" received by him prior to 1936; to his repeated demands for payment, the withholders answered that they would not release the funds until the litigation was concluded, or the parties thereto reached agreement concerning their disposition.

Neither were these funds taxable to petitioner prior to 1936 as his distributable share of the income of a "partnership" within the statutory definition of that term. See Section 1001 (a) (3) of the Revenue Act of 1936 (Appendix, *infra*). It is not necessary to consider whether determination of the relationship existing under the oil-lease assignments between petitioner and the assignee-withholders was a question of law as petitioner contends (Pet. 7-8), or an inference of ultimate fact as the court below held (R. 291). For we submit that no conclusion other than that this relationship was not within the ambit of Section 1001 (a) (3) could be sustained on the record. The only factor which conceivably pointed to joint venture was that under the assignment petitioner apparently retained an economic interest in the oil and gas in place to the extent of the payments reserved. Cf. *Thomas v. Perkins*, 301 U. S. 655. But he was clearly not an associate in a venture;² he was merely a pas-

² Under the assignment no "venture" was in fact undertaken. The assignee did not agree to drill any wells, except protective offsets, or otherwise to develop the property; such undertaking was in fact expressly negatived. Cf. *Ortiz Oil Co. v. Commissioner*, 102 F. 2d 508 (C. C. A. 5th); *Helvering v. Armstrong*, 69 F. 2d 370 (C. C. A. 9th); *Reynolds v. McMurray*, 60 F. 2d 843 (C. C. A. 10th).

sive recipient of a stipulated amount of the proceeds from operations carried on by the assignees.³

CONCLUSION

There is no conflict and the decision below is correct. The petition for certiorari should be denied.

Respectfully submitted.

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JULY 1943.

³The stipulated payments were to be made to petitioner entirely free of expense to him (R. 27). Cf. *Helvering v. Armstrong, supra*; *Reynolds v. McMurray, supra*. And the assignee agreed to pay petitioner a minimum per barrel price for all oil sold, with an option in itself to purchase at the average posted price subject to the minimum (R. 27). Petitioner was not to "share" in the profits; after the agreed \$1,000,000 was paid him by the assignees, he had no further interest in the proceeds of production or in the source (R. 27). He had no voice in the management or conduct of the enterprise, nor was management "delegated" by him to the assignee. Cf. *Commissioner v. N. B. Whitcomb, Etc.*, 95 F. 2d 596 (C. C. A. 5th).